Structural Change and Macrodynamic Capabilities

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Abstract

In this paper we intend to study some mechanisms that block a rapid diffusion of technological progress from advanced to underdeveloped countries. In order to accomplish this task we focus on two approaches that challenge the view that technological gaps between rich and poor nations are diminishing. The first is the structural economic dynamic approach and the second is the evolutionary view. Both of them reveal that the elimination of the technological gaps between rich and poor nations is more complex than what is been reported by the mainstream theory of economic growth.

Keywords: Structural Economic Dynamics, Uneven Development, Evolutionary approach, Engel's Law.

JEL Classification Number: O19, F12

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1. Introduction

In this paper we intend to show that the Evolutionary approach may be adopted to endogenize technical progress in the Structural Economic Dynamic – SED hereafter – approach. Besides we intend to show the relevance of the SED approach extended to consider endogenous technological progress to tackle the existence of technological and per capita income gaps between developed and underdeveloped countries. It is widely accepted that one of the stylised facts about the relations among rich and poor countries is the widening gap between their per capita incomes. According to Dutt (2002, p. 369), "an examination of the recent literature on technology transfers suggests that convergence is not a foregone conclusion, and that it is much more likely that convergence is likely to take place within rich countries, with many of the poorer countries left out of the process." In the neo-classical theory of growth there is no room for a widening gap since the exogenous growth rate of technical progress determines the overall growth rate[1]. According to Fagerberg (1994, p.1147), in this theory "technology is assumed to be a public good and subsequent empirical research showed that a theory based on this premise explains very little of the observed differences in growth across countries."

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[1] Schumpeter (1934) had already emphasised that the technological progress is the engine of economic growth. The neo-Schumpeterian School has been focusing on the determinants of creation and diffusion of technological progress. Bresnahan and Trajtenberg (1995, pp.83-84) claim that economists have known for a long time that technical change is the single most important force driving the secular process of growth. Yet, relatively little progress has been made in accounting for the Solow's residual of aggregated production functions, largely because economic theory tends to treat all forms of technical change in the same diffuse manner.

Denying the complexities involved in the process of innovation and its diffusion, the neo-classical model focuses on issues that can be addressed within a limited scope of a one-sector framework and considers that the only barrier to diffusion of technology from advanced to underdeveloped countries is the cost of imitation and adaptation. Being this analysis made without considering the complexities of the innovation processes, no attention is given to the dynamic capabilities of firms facing particular environments, institutions and labour skills in advanced and underdeveloped countries. In this case the technical progress attained by the firms in the former countries is easily transferred to those in the latter[2].

This reasoning can be considered a benchmark for the revival of the neo-classical theory of growth, known as the 'New Growth Theory'. Since the evidence had shown that technology could not be treated as a public good, the mainstream economics was challenged to justify the theoretical convergence of per capita income that is hardly seen in practice if we consider developed and underdeveloped nations

Grossman and Helpman (1991, p. 238) have built models in which a higher degree of openness allows developing countries to adopt technologies from the advanced nations at a faster rate and thus to grow, in equilibrium, more rapidly than with a lower degree of openness. According to them "countries that trade in world markets invariably learn a great deal about innovative products and about the novel methods that are being used to produce

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[2] According to Metcalfe, Ramlogan and Uyarra (2003, p.40) "While the idea of semi stationary or proportional growth may have been helpful in the early stages of growth theory, as for example, in the Von-Neumann growth model, it cannot help in the context of understanding development since it rules out, ex hypothesis, the most important of all the stylised facts, structural change."

older goods." In the same vein Lucas (2000) relies on the mechanism of international learning for convergence: poor countries are simply to assume to learn from the experience of rich countries and to catch up to them.

In this paper, departing from the structural economic dynamic and the evolutionary approaches, we intend to show that the diffusion of new technologies is harder than what is been reported by the mainstream literature. From the structural economic dynamic approach we can focus on changes in the sectoral composition of an economy due to the existence of particular rates of technical progress and growth rates of demand for each of the sectors. The existence of the non-homothetic tastes is shown to create some mechanisms that block a rapid diffusion of technological progress from advanced to underdeveloped countries. Besides the evolutionist approach, by focusing on the dynamic capabilities of firms, can show us that the process of innovation, even if made through imitation, is more complex than what is been reported by the mainstream literature on technological transfers. In the next section we analyse the structural economic dynamic approach to technological gaps and in section 3 we focus on the barriers posed by the evolutionary approach. Section 4 concludes.

2. Engel's Law as a Constraint to the Diffusion of International Technical Progress

In this section we focus on the evolving patterns of demand and productivity growth as important elements determining the capability of absorption of foreign technical progress. The central idea is that different rates of growth in demand, governed by different

income elasticities, and international evolution of tastes critically affect international learning and diffusion of technology[3].

According to Pasinetti (1981, 1993) structural change refers to variations in the sectoral composition of the economy due to the existence of particular growth rates of demand and technical progress in each sector. Pasinetti (1993, p. 39) considers that there exists a minimal set of information on the evolution of consumption patterns, which may be conveyed by the following three points:

(i) as per capita income increases, a marked tendency emerges, for each consumer, not to increase proportionally the demand for various goods, but rather to follow, in satisfying various needs, a certain hierarchical order, by first satisfying essential needs an then gradually moving on to the satisfaction of those needs that are less and less essential.

(ii) The variation in the composition of the consumption may well occur independently of the increase in income and of the changes in prices, as a consequence of the appearance on the market of newly invented goods and services.

(iii) There is no good for which the consumption of an individual can increase indefinitely. A saturation level exists for the consumption of any good and service, even if this saturation level may be reached at different speeds for different goods or at different levels of per-capita income.

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[3] We recognise that when technological change is effectively added to the productivity process it affects the structure of the economy as will be considered below.

It is important to mention that despite the fact that technical change plays a central role, taking place at a different pace in the various sectors, it is exogenously determined in the Pasinetti's model. Some authors such as Reati (1998) went a step further and have introduced long waves in this model, assuming that productivity growth is fundamentally driven by technological revolution, which gives rise to a complex dynamic involving a set of prices, physical quantities and employment. However the origins of this revolution remain unexplained in this framework.

It is at this point that the evolutionary approach is best suited to provide the structural economic dynamic approach the tools to endogenise innovation, what is the focus of the next section. In fact, if one on hand the evolutanionary view can provide the explanation for technical progress and innovation, something that is missing in the structural economic dynamic approach, on the other hand, the later may clarify the connections between technical progress and structural change, something that is not highlighted by the former.

Metcalfe, Ramlogan and Uyarra (2003) have studied the relationship between competition for innovation and structural change. According to them, "The correspondence between evolution, competition and development is exact. Each is a theory of the growth of specified entities and populations of entities and since the focus is upon differences in growth rate the natural implication is that development and competition entail structural change." (Metcalfe, Ramlogan and Uyarra, 2003). Although providing an important link between competition and structural change, these authors do not focused on a detailed explanation on mechanisms that act as the link between competition and structural change.

This gap is fulfilled by the structural economic dynamic approach to economic growth. According to it, technical progress raises the productivity and increases the per

capita income but this higher purchasing power is not translated into a proportional increase of demand for different goods and services due to the Engel's Law. Hence the changes in the composition of demand will give rise in the side of production to variations in the sectoral composition of the economy, which is nothing but the structural change.

In order to understand the importance of this mechanism as a barrier to the diffusion of technological progress amongst countries it is useful to consider the existence of two countries denoted by A, for advanced, and U, for underdeveloped. Assume, for the sake of convenience only, that they produce the same set of commodities with different methods of production but the same structure of costs for each single good. This corresponds to the situation in which consumer preferences are homothetic in both environments, giving rise to the same structure for economies with different levels of national income. It is assumed that all commodities can be produced in A with 1/10th of the labour they require in U. In this case the new methods of production developed in the advanced countries are directly applicable for both countries since the sectoral composition of both economies is the same. It follows that learning new techniques from abroad arises as a straightforward source of gains from international relations in this unrealistic set up.

Although the hypothesis of homothetic tastes is useful as a first approximation, the analysis may well be enriched when it is dropped, allowing us to consider the effects of evolution of human needs and preferences on the sectoral composition. Non-homothetic tastes give rise to entirely different compositions of demand and, therefore, different structures of production and employment, according to the particular levels of real per capita income in each of the countries.

In this vein it is possible to consider the effects of the Engel's law on the diffusion and absorption of technological diffusion where uneven growth is the most probable

outcome. In such an environment the path of diffusion and absorption of new technologies will reflect, on the input side, the order of priorities in which production of consumption goods is organised according to the consumers' preferences. Technical change that an underdeveloped country can take advantage is partial since there is a definite order in which the production process can be enlarged according to the increases in demand as income expands. Actually, there is an almost fixed order in which the production process can be enlarged and methods of production can be learnt[4]. In this vein, Engel's Law, which gives rises to non-homothetic tastes and particular structures of consumption and production for each country or region, constitutes one of the mechanisms blocking prompt diffusion and absorption of international knowledge in developing countries.

Besides technology transfer to the developing countries will not necessarily increase its growth rate, but may reduce the rate of labour absorption, having negative impacts on the employment level. The extent of this phenomenon depends on institutional characteristics of the developing countries, such as the flexibility of the labour legislation and the skills of the labour force, an issue that will be addressed in the next section.

In fact, recent literature tends to admit that a large portion of technical progress is specific to capital goods. If it is true the capability of underdeveloped countries to absorb foreign technical progress is connected to the availability of capital goods to use new technologies. Balance of payment constraints may damage the capability of the developing countries to adopt technology from abroad. In general, to use advanced technologies, such a

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[4] According to Pasinetti (1981, p.75) "although possibilities of substitution among commodities are of course relevant at any given level of real income, there exists a hierarchy of needs. More precisely, there exists a very definite order of priority in consumers' wants, and therefore among groups of goods and services, which manifests itself as real income increase".

countries must import that equipment that is directly or indirectly necessary for mastering the new technologies but that cannot be produced at home[5]. Importing such advanced machine may be prevented by an intertemporal balance-of-payments constraint, which is a consequence of the Engel's law. Accordingly, for most of the underdeveloped countries, only exportation of primary products, with low foreign demand elasticities, is available. Hence the balance of payment constraint on growth that springs from the Engel's law has a negative effect upon the adoption of new technologies learnt from abroad[6].

Any analysis of the North-South linkages from which reliable policy conclusions are to be drawn should take into account not only technical progress but also the barriers to its diffusion and absorption due to the particular structure of economies with different levels of per capita income and labour skills.

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[5] As pointed out by Oda (1999, p. 208) "learning new techniques without importing any capital goods is also meaningless unless all the capital goods that are directly or indirectly necessary for using the learnt techniques can be produced at home. The importation of advanced capital goods is not the origin of acquisition of new techniques, but the latter is almost inevitably accompanied by the former."

[6] Thirlwall (1994) argues that the effective constraint to long-term steady growth of underdeveloped countries, at a high rate, is the long-run rate of growth of exports, combined with the long run elasticity of demand for imports in relation to the national income (output). His balance of payments constrained growth model and the so-called Thirlwall's Law have typically been used to analyse the determinants of growth for industrialised nations. Moreno (1999), and McCombie and Thirlwall (1994) deal with developing countries. Lopes and Cruz (2000, p.478) pointed out that "All these studies have been carried out under the (implicit) assumption that the real terms of trade or real exchange rate remain constant in the long run". Dutt (2000) relates Thirlwall's approach to a model of North-South trade to show how it may explain uneven development. The Journal of Post Keynesian Economics, vol. 19, No.3, Spring 1997, provides a "Minisymposium on Thirlwall's Law and Economic Growth in an Open-Economy Context".

3. An Evolutionary Approach to Technological Gaps

The paradigmatic nature of technological progress has important consequences in terms of its diffusion amongst firms operating in different environments and subject to particular conditions of credit constraint, labour skills etc. According to Dosi (1988, p. 1127) a technological trajectory can be defined as "the activity of technological process along the economic and technological trade-offs defined by a paradigm". This means that in general there is a path created by the acquisition of technological progress, which has to be followed by firms in a sector if they want to succeed.

Besides this process is at the same time selective and cumulative and these characteristics give rise to an ordered path that technological progress follows in a specific sector. The neo-classical theories tend to ignore the importance of this order, considering the tasks of imitation and innovation easier than what they really are in practice. Barro and Sala-i-Martin (1999, p.266) have reported that "(...) follower countries tend to catch up to the leaders because imitation and implementations of discoveries are cheaper than innovation. This mechanism tends to generate convergence even if diminishing returns to capital or to R&D do not apply." Note that the central point of the studies above is that imitation and adaptation of technologies is cheaper than finance R&D. But this view has been disputed by some authors such as Dosi (1988, p. 1140) who states that "In general, it must be noticed that the partly tacit nature of innovative knowledge and its characteristics of partial private appropriability makes imitation, as well as innovation, a creative process, which involves search, which is not wholly distinct from the search for new development, and which is economically expensive – sometimes more expensive than the original innovation."

The assimilation of these technological paths by firms of other countries may involve high costs. The advent of the 'New Economy', understood as the rapid advances of information and communication technology extending labour productivity, is a striking example of the particular nature of technological progress that is being generated in developed countries and which is hardly adopted by underdeveloped nations. Acemoglu (2002, p.63) points out that "(...) new technologies developed in the rich economies are typically 'too skill-biased' for LDC, the recent acceleration in skill bias could have negative implications for the LDCs". According to him the bias of the technical progress is mainly determined by the qualification of the available labour force. In this vein skilled biased technical progress was generated in advanced countries because there was a supply of skilled workers in those countries. Of course this is not the scenario observed in underdeveloped nations, where the labour force is characterised by low qualification. One could figure out that skilled biased technical progress would produce a skilled labour force in the less developed countries (LDC's). But this is exactly the contrary path observed in advanced countries.

Another important characteristic of technological diffusion raised by Acemoglu (2002) is that a new technology is adopted only if is more profitable than the available technologies. There are a large number of new technologies developed in the advanced countries that are not profitable to be adopted in underdeveloped countries. In the advanced country the most productive technology is in general the most profitable one. In the underdeveloped case the most productive technology may not be the most profitable one due to costs involved with the adoption and training the labour force to use the new technology.

In fact, a number of recent contributors have emphasised the role of skill resources. It is quite obvious that the process of technology absorption is affected by the skills of the labour force and this is a crucial constraint on the selection of the technological profile to be implemented by a developing economy. Parente (1994), studying technology adoption, learning by doing and economic growth, stresses that adoption costs may well take different forms, including institutional and legal constraints. He argues that barriers to technological progress, such as tariffs or import restrictions can explain some of the disparities of income levels across countries. As his approach is supply driven he does not mention that some barriers are imposed by balance of payments constraints.

Gonzalo (2002) focuses on the processes of adoption and maintenance of new technologies as well as their, shall we say, consequences to the growth and development strategies. His main objective is to explain differences in the use of investment goods due to the high costs of implementation of new technologies, given the same available technological menu. Naturally, maintenance costs affect the adoption process.

Adoption costs have been repeatedly invoked to explain technological sclerosis and higher age of capital in developing countries. Of course, an increase in the absorption costs of technological improvements generated abroad not only lower the short run growth rate in the less advanced countries but also decreases the speed of convergence towards the advanced ones. According to Bessen (2002, p.444), "(...) whole new technologies may incur large adoption costs because they involve learning new skills, implementing new forms of organization, and developing complementary investments". Surely, the technological gap increases with the size of the absorption costs.

As a summary, the investment-specific nature of technological progress in the 'New Economy', added to the balance of payments constraints and to the deterioration in the

terms of trade, make the diffusion and absorption of new technologies in the South a daunting task.

4. Concluding Remarks

In this paper we have focused on some mechanisms that block a rapid diffusion of technical progress from advanced to underdeveloped countries. From the structural economic dynamic and evolutionary approaches we highlight some mechanisms that prevent firms in the underdeveloped countries to catch up to the technological frontier. The structural economic dynamic approach allows us to study the issue from a sectoral level while the evolutionary approach focuses on the dynamic capabilities of firms to show the complexity of the innovation process, even if it is made through imitation.

The basic lesson to learn is that the diffusion/absorption of technological progress relies heavily on characteristics of the particular environment of the firms or sectors such as the level of per capita income, the set of institutions, the skills of the labour force etc. Unfortunately, the dominant neoclassical literature on economic growth is inadequate to deal with the issue of technological transfer since its frameworks cannot take into account the complexities of the innovation process and conditions particular economies[7]. This theory applicable to developed nations were based on economic background (or structure) where near full employment prevailed, as well as an adequate stock of capital and the balance of payments constraints were not too severe.

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[7] According to Metcalfe (1988, p.167) "the economic analysis of technical change is not a straightforward matter. The familiar tools of equilibrium economics are best suited to discussing the long-run effects of new products and methods of production; they are not well suited to analysis of the disequilibria processes by which new technologies are generated, improved and absorbed into the economic structure."

On the other hand the theory of development applied to backward countries needs to take into account a set of initial conditions such as unemployment, subsistence wage level, shortage of capital etc. Needless to say that choosing among alternative trajectories of development depends upon the degree of backwardness when planning for growth is initially undertaken. To close both technology and income per capita gaps may well require a temporary protection by a number of tariff and non-tariff barriers to trade and industrial policy with a variety of incentives, credit subsidies and price controls.

The syntheses of the analysis presented here is that the structural economic dynamic and the evolutionary approaches of the systems should be considered as the stand point for the creation of a proper environment for international learning in underdeveloped countries. We acknowledge that more than one policy strategy follows from an understanding of the obstacles to diffusion and absorption of technical progress posed by Engel's law and by the complexities of the process of innovation. A possible conclusion is that poor regions need to induce structural changes in their economies that take into account the complexities of the innovation process.

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